Journal of Nusantara Studies 2023, Vol 8(3) 429-452
Universiti Sultan Zainal Abidin
ISSN 0127-9386 (Online)
http://dx.doi.org/10.24200/jonus.vol8iss3pp429-452

ASSESSMENT OF VALUE-BASED PRINCIPLES ON ISLAMIC BANKING PRACTICES IN MALAYSIA: AN EXPLORATIVE STUDY USING BANK'S DISCLOSURE

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Received: 15.05.2023 Accepted: 17.08.2023

ABSTRACT

Background and Purpose: This study aimed to understand banking practices to legitimise their role in society and meet stakeholder needs in terms of their products and services. This study narrowed its scope to use the underpinning thrust of value-based intermediation (VBI) as it is a primary pillar of the VBI framework. Towards these same ends, the study also sought to gauge how banks integrated their products and services with the framework.

Methodology: This study employed the triangulation approach, which comprised of a content analysis of annual reports of the bank and trend analysis of court cases. This study used Bank Islam Malaysia Berhad (BIMB) as an explorative study.

Findings: The findings indicated a decrease of total occurrences over the years on litigation cases involving BIMB, related to know-your-customers compliance. Meanwhile, the analysis of annual reports of the bank indicated that *shariah* non-compliance incidents are due to operational failures and lack of *shariah* knowledge among the staff. This study highlighted the need for the banks to strengthen the know-your-customer compliance, besides enhancing and promoting Islamic financial literacy and ethics to their stakeholders.

Contributions: This study contributes a novelty in this area of study by using data triangulation on court cases and annual reports to provide a more comprehensive perspective on the issue. This study also added to the current literature on VBI, especially within Malaysian context.

Keywords: Corporate responsibility, due diligence, know-your-customer, Islamic ethics, financial literacy.

Cite as: Talib, S. A., Mohd Iskandar, T., & Muda, R. (2023). Assessment of value-based principles on Islamic banking practices in Malaysia: An explorative study using bank's disclosure. *Journal of Nusantara Studies, 8*(3), 429-452. http://dx.doi.org/10.24200/jonus.vol8iss3pp429-452

1.0 INTRODUCTION

Banks as financial intermediaries play a crucial role in mobilising funds and allocating the resources to generate values to their stakeholders. Indeed, banking institutions emerged with new models that uniquely positioned them to foster economic sustainability by offering innovative and value-based financial services and products to serve wider stakeholders (GABV, 2019). In this regard, the United Nations Sustainable Development theme of "Transforming our world: The 2030 agenda for sustainable development" (UNDP, 2015) has gained substantial momentum, creating coercive forces for adoption by emerging financial markets, including Islamic financial institutions. There are various strategic publications issued to promote the creation of sustainable Islamic banking ecosystems, which focus on shifting from *shariah*-compliant financial products and services offering, towards delivering value propositions to the wider stakeholders within the society and the economy at large.

In Malaysia, the central bank of Malaysia (BNM) issued a strategy paper entitled Value-Based Intermediation: Strengthening the Roles and Impact of Islamic Finance (BNM, 2018). The strategy paper provides an overall strategy to facilitate Islamic banking institutions to adopt relevant practices, conducts, and offerings, which produce positive and sustainable impact towards the economy, community, and environment, without compromising the financial returns to the shareholders. In addition, BNM's Financial Sector Blueprint 2022–2026 stated its aim for wider adoption of sustainable financing, which is also referred to as value-based intermediation (VBI) financing in Malaysia (BNM, 2022a). Whilst BNM promotes the VBI concept as a new strategy, the intended outcomes from the implementation of VBI are similar with several well-established concepts, such as Environmental, Social, and Corporate Governance (ESG), Ethical Finance, and Sustainable, Responsible, Impact Investing (SRI)

(Arshad et al., 2018). Nevertheless, *shariah* as the main reference applied in VBI determines the underlying values, moral compass, and priorities.

Even though all Islamic banks in Malaysia are *shariah*-compliant under the supervision of BNM (Law of Malaysia, 2013), studies on how the implementation of VBI has brought changes in Islamic banks are rather limited. Banks that implement VBI practices differ from other banks as they have modified their business models and focused on value-based activities (Tok & Yesuf, 2022). The performance measures of VBI varied among distinct Community of Practises based on their respective levels of adoption (Engku Abdul Rahman et al., 2022). Furthermore, Islamic banks' activities are continuously focusing on compliance to *shariah* in ensuring the legitimacy of Islamic financial products and services. Hence, it is vital to explore the importance of adopting VBI in the banking practices in enhancing services provided by the bank and leading towards achieving the intended outcomes. Therefore, this study aimed to better understand the question of changes in the banking practices to legitimise their role in society and meet stakeholder expectations in terms of their products and services. This study narrowed its scope to use the VBI underpinning thrust as it is a primary pillar of the VBI framework. Towards these same ends, we also sought to gauge how banks integrated their products and services with the framework.

In this study, court cases are used as a source of data due to an increasing occurrences of Islamic finance court cases related to the products and services provided by the banks (Oseni et al., 2016). Zakariyah (2015) also highlighted the issue of lack of moral consideration of *shariah* in *shariah*-based products, while Agensi Kaunseling dan Pengurusan Kredit (2018) called for attention towards the promotion of debt-based financing that led to high debt-to-income ratio among low-income Malaysian. Meanwhile, lacked of expertise among practitioners and market participants' financial illiteracy left the doors wide open for criminal-related transactions (Latif & Abdul-Rahman, 2018; Mugarura, 2017) and misconducts (Bakar & Yasin, 2019). Court cases matter as it was argued that litigation (court cases) provided an independent assessment by stakeholders about the quality of an institution, which may affect the corporate reputation of the institution (Shapira, 2016). This study offered the adoption of a triangulation approach, comprising of content analysis and trend analysis of court cases, and analysis on selected items from the bank's annual report disclosure of non-*shariah* compliance and fraud incidents, aside from the gross default exposure and credit-risk mitigation of Bank Islam Malaysia Berhad (BIMB) as an explorative study. The remainder of the paper is organized as follows: literature review, research design, analysis and discussion, and conclusion of this study.

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2.0 LITERATURE REVIEW

2.1 Mapping Issues in Islamic Banking Services and The VBI Framework

One of the main issues discussed in the literature of Islamic banking is *shariah*-related issues on contracts in Islamic banking financial services. Other issues related to know-your-customer compliance may be further classified as financial debt burden, criminal-related activities, and disputes due to lack of transparency or consumers' lack of understanding. Figure 1 illustrated the mapping of cases based on the classification of the four underpinning thrusts. The underpinning thrusts are the primary pillar of the VBI framework. According to the strategic paper issued (BNM, 2018), Islamic banks should ensure their strategies and performance manifests these four underpinning thrusts, which are entrepreneurial mindset, community empowerment, good self-governance, and good conduct. The outcome of this framework can be achieved by expanding the business landscape to absorb the three sustainability pillars (profit, people, and plant), supporting innovation and creating value, and involving the key stakeholders (Arshad et al., 2018). It was suggested that crime-related cases fell under good self-governance category, while *shariah* or contract-related cases fell under the good conduct of Islamic banks. Disputes and default cases, on the other hand, fell under community empowerment as these cases may not lead to a favourable impact on certain parties.

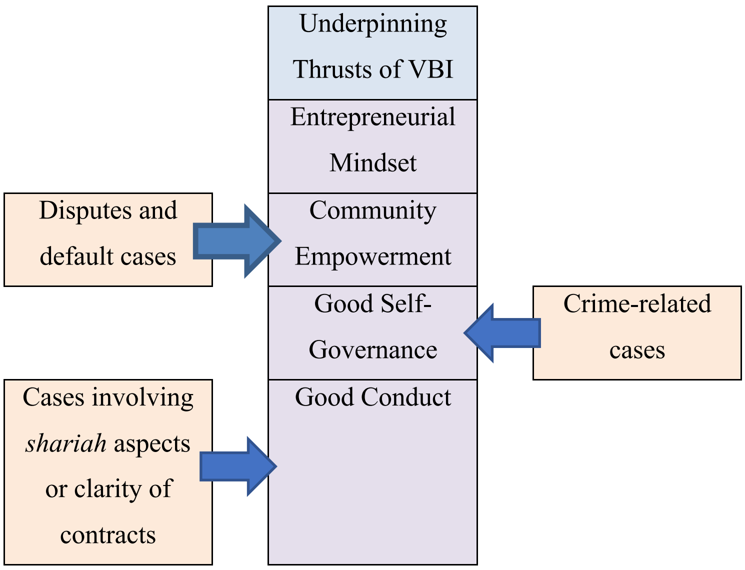

Figure 1: Matching cases and underpinning thrusts of VBI

Firstly, issues related to *shariah* aspects of banking products were highlighted by some authors. Zakariyah (2015) raised an issue in integrating legal and moral aspects of *shariah* to *shariah*-

based products. Zakariyah (2015) deemed that a *shariah*-compliant product needed to be judged in terms of both its form (legal aspects) and substance (moral aspects) to deliver the outcomes of *shariah*. As Islamic financial products replicated conventional products, the focus was given on products' form and design instead of the substance (Mansour et al., 2015). In the case of Malaysia, this issue involved the usage of the bai' 'inah contract for house financing (Muneeza et al., 2020), charging guarantee-fee, and inclusion of rebate in the financing agreement (Eldersevi & Haron, 2020). As cited in Zakariyah (2015), Siddiqi also highlighted the issue of debt proliferation within the debt-based practices of Islamic banks, which may lead to inflationary expansion.

Secondly, alarming concern on the bad impact of the debt-based practice was clearly expressed by Agensi Kaunseling dan Pengurusan Kredit (2018) via the finding of a survey done on Malaysians. The finding depicted that Malaysian working adults with an income of less than RM2,000 had a debt-to-income ratio of 49% (Agensi Kaunseling dan Pengurusan Kredit, 2018). High indebtedness also was found whereby around three out of ten Malaysian working adults cannot afford essential goods without borrowing (Agensi Kaunseling dan Pengurusan Kredit, 2018). Ramli et al. (2018) also found that from 2008 to 2015, commercial domestic banks were significantly and negatively impacted by non-performing loans. Nizar and Karim (2021) also found a significant negative relationship between household credit (mortgage credit and consumer credit) and the stability of Malaysian commercial banks. The above happened despite the fact that Malaysia's non-performing loans for banks were maintained at less than 5% since 2008 and maintained at 1.6% from 2014 to 2017.

Thirdly, the banking industry is exposed to criminal-related transactions. For example, consider the 1MDB controversy in Malaysia, which was investigated not only in Malaysia, but also in other countries, including Singapore, Switzerland, and the United States of America (Jones, 2020). The scandal consequently questioned the thoroughness of due diligence conducted, and internal compliance adherence by the banks despite any political interference (Jones, 2020). Parallel to this issue, interviews conducted by Jamaliah et al. (2013) with 39 compliance officers of Malaysian commercial banks found a lack of top management support, expertise, political support, technological infrastructure, and resources cause hindrance to the implementation of compliance measures within the banks. Similarly, Latif and Abdul-Rahman (2018) found a lack of expertise within Malaysian banking staff as the main barrier for effective implementation of Anti-Money Laundering regulations. Additional causes found were customers' lack of knowledge and awareness about money laundering (Latif & Abdul-Rahman, 2018). Besides, it is vital to note that the global financial crisis in 2008 was rooted in negligence due to the diligence process by service providers (Grosse, 2017). On the other hand, financially illiterate market participants expanded the crisis as they failed to make a wise financial judgement about the available financial instruments and entered into unhealthy financing instruments (Grosse, 2017).

Lastly, while banks have the duty of care towards their customers, a study conducted on 151 bank customers in Germany, the United Kingdom, and the United States found that 65% of the bank customers did not fully understand the signed terms and conditions on bank fraud reimbursement, while almost 30% of respondents deemed important sections as unclear (Becker et al., 2017). Bakar and Yasin (2019) conducted a study on case laws, legislations, and documentary references, where they found that there were widespread of misconducts and frequent incidents of unfair treatment provided by Islamic banks. The issues on duty of care in delivering services is important as a study on Pakistani bank customers in the context of Car Ijarah financing found that customer's perception and customer's satisfaction were mediated by service clarity and accuracy (Adeinat et al., 2019).

2.2 Three Elements of Corporate Responsibility Practices: Due Diligence, Financial Literacy and Islamic Ethics

This section included discussion on three elements of corporate responsibility practices which are the concept of due diligence, financial literacy, and Islamic ethics. The discussion of previous studies such as Hardouin (2009), Dewa and Zakaria (2012), Widana et al. (2015), Mugarura (2017), Salh and Mohammed (2019), Losada-Otalora et al. (2020), Aydin (2020), and Kurowski (2021) on these three elements suggested that these aspects may address issues related to *shariah* non-compliance events, financial crimes, customers' default on payment, and disputes between contracting parties.

2.2.1 Corporate Responsibility of Due Diligence via Know-Your-Customer Policy

The concept of due diligence for business enterprise comprises of two aspects: "its responsibility for its adverse human rights impacts and responsibility for the human rights impacts of third parties with which it has business relationships" (Bonnitcha & McCorquodale, 2017, p. 912).

As per the interpretation of the due diligence concept by Bonnitcha and McCorquodale (2017), banks need to adhere to the know-your-customer policy (due diligence process), which is the most pivotal basis of the compliance function in the financial sector (Hardouin, 2009). Due to the position of the financial sector within the economy, building governance via adherence to the law is the basis against crimes. In keeping up with the digital era, BNM issued the 'Electronic Know-Your-Customer (e-KYC)' policy in the year 2020 (BNM, 2020a). e-KYC refers to the electronic ways of performing customer due diligence and establishing a business relationship (BNM, 2020a). Financial institutions are required to implement e-KYC in applying an appropriate mix of authentication factors to ensure effectiveness in addressing the associated risks. These are risks associated with customer information, operational, human capital, information technology, money laundering, and terrorism financing (BNM, 2020b). Concerning customer information, three basic-authentication factors to be verified are their possession, private information, and biometric characteristics. Additional measures, such as biometric technology, fraud detection mechanism, and liveness detection, may be applied to enhance the effectiveness of electronic know-your-customer technology (BNM, 2020b).

In overcoming loopholes or leakages in financial systems and regulations towards better governance in the financial sector, Hardouin (2009) mentioned the crucial need for strengthening coordination among industry players via harmonisation. This response is also paramount because criminals, including professionals, who are enablers of crimes (Levi, 2021), snoop on internal governance's weaknesses to serve their interests (Mugarura, 2017). The human limitation also contributes to a greater misidentification risk, hence giving lower identification assurance (BNM, 2020b).

The adoption of e-KYC policy addresses the completeness between financial integrity and financial inclusion (Alliance for Financial Inclusion, 2019). However, emphasis on compliance risk may divert the attention and actions from the goal or outcomes of mitigating money laundering and terrorist financing risks, which may not be overcome via the requirement of documentation (Alliance for Financial Inclusion, 2019).

While banks discharge due diligence to prevent financial crimes (from third parties) via a know-your-customer policy, they must also exert voluntary corporate responsibility in the area of education (financial literacy). This is due to the fact that financially literate employees are required for banks to fulfil their due diligence obligations besides equipping customers with financial education to protect themselves and benefit from financial solutions.

2.2.2 Voluntary Corporate Responsibility of Financial Literacy

All financial literacy refers to a combination of awareness, knowledge, skill, attitude, and behaviour necessary to make sound financial decisions and ultimately achieve individual financial well-being. Financial literacy does not only play a role as one of the primary initiatives in combating financial crimes (Mugarura, 2017) but also to enhance financial inclusion (Hasan et al., 2021) besides reducing the risk of defaults (Kurowski, 2021).

Since organisations must address stakeholders' well-being to gain long-term benefits (Nwanji & Howell, 2007), financial institutions need to ensure the well-being of their stakeholders, including customers. Banks need to take reasonable precautions to protect their customers' well-being, such as by shielding them from the potential risks of making rash financial decisions (Losada-Otalora et al., 2020). Thus, a bank may deliver its duty towards consumers via the provision of financial information or knowledge to consumers (Losada-Otalora et al., 2020). First and foremost, bank employees must acquire sufficient *shariah* knowledge of Islamic banking to communicate financial information and educate consumers on financial knowledge (Dewa & Zakaria, 2012; Salh & Mohammed, 2019).

Consumers then should improve their financial literacy by making efforts to become financially literate, embed positive financial behaviours, have the financial ability to make wiser financial decisions (Paul & Ong, 2020), and develop their ability to internalise the inherent risks of financial products and schemes before engaging in those schemes (Mugarura, 2017).

Financial literacy of banks' employees and consumers consequently affects the banks' performance. The effect of consumers' financial literacy in improving loan or financing performance of banks was found by Onyango (2018) based on research conducted on banks in Kenya. Research on financial institutions in the Netherlands also found that financial literacy as the key to consumers' trust in financial institutions. The above findings are supported by Kearney (2018). Kearney (2018) found customer service (towards customer's best interest) and clear communication by employees led to customer trust, while trust led to a positive tangible bottom-line impact on banks.

Aside from financial literacy, Islamic ethics also needs to be acquired and practised by employees and consumers. Islamic ethics should guide the bank and customers towards implementing the best conduct.

2.2.3 Islamic Ethics to Guide Conducts in Discharging Responsibility

Parallel to the need for financial literacy, this study suggests Islamic ethics as a deterrence measure against misconduct and guide actions of the players in the Islamic finance sector, especially in performing their responsibilities. Knowledge is a crucial aspect of ethics, knowing what an individual ought to do (Vishanoff, 2020). On the other hand, Aydin (2020) reiterated the idea of Al-Attas, an Islamic scholar, that knowledge without ethics causes the rise of ethical issues. Thus, while financial literacy is a requirement for customers to profit from financial services, Islamic ethics is promoted as the key towards best conduct by all transacting parties.

While established laws lessen the likelihood of misconduct, they cannot prevent misbehaviour or crimes when the extrinsic or economic gains of misconduct outweigh the cost of breaking the laws (Klimczak, 2021). To complement the laws as deterrence measures of misconduct, Klimczak et al. (2021) suggested the combination of intrinsic and altruistic motivations under the virtue theory in which virtue's main objectives are human excellence and flourishing. It is parallel to Islamic ethics, which is rooted in the Islamic worldview or Tawhidic paradigm (Aydin, 2020). In essence, the purpose of our creation is solely to worship Allah (Quran, 51:56). Thus, all actions, including living and dying, are for Allah (Quran, 6:162), whereby Islam, iman, and ihsan (excellence) are the three fundamental aspects. The virtuous choice is a rational decision for people who have attained ihsan, guided by their certainty in the existence of the Creator and His rewards (Aydin, 2020).

The idea of virtuous choice or rational decision mentioned by Aydin (2020) is parallel to Al-Juwayni's ethical structure. The structure defined Islamic ethics as the knowledge of determining necessary action or moral truths (Vishanoff, 2020). Thus, Islamic ethics (knowledge) guides individuals towards Islamic ethical behaviours (actions) and Islamic values (virtues). Meanwhile, this study differs from Manan et al. (2013) whom defined Islamic work ethics as "a set of values and principles that guide individuals' rights and responsibilities at work based on Islamic teachings…".

The ethical structure of Al-Juwayni's legal theory as explained or commented on by Vishanoff (2020), disintegrated virtue and ethics. Virtue is non-deontic; however, ethics is deontic. Every action has a legal value from the perspective of legal theory. Legal value is determined by legal science or also known as knowledge of the law. Based on Vishanoff's (2020) translation of Al-Juwayni's legal theory, legal science is technically defined as knowledge of determining rewarding actions and punishable actions. Legal science is derived via interpretive reasoning and enhanced through diligent inquiry of the timeless revelation (Vishanoff, 2020).

Subsequently, in Islamic legal theory, legal science also places ethics as an individual responsibility associated with personal consequences (Vishanoff, 2020). Hence, Vishanoff (2020) highlighted that the aim of ethics, according to Al-Juwayni's legal theory, is individualistic. Even from a non-Islamic perspective, though being ethical is self-serving (for one's own self-interest), an act can be deemed ethical based on the act alone regardless of the reason behind the act (McCartney & Parent, 2021). Even for an altruistic aim, the goal is yet individualistic due to the end goal of extrinsic reward from the Creator (Vishanoff, 2020). Aydin (2020) agreed to this as the author stated that a person who reached ihsan (excellence) has absolute certainty in God's existence and His promises on reward, which guides him in making a rational decision.

The importance of Islamic ethics (deontic) as a branch of knowledge required to develop ethical behaviours is highlighted in this study. Although Manan et al. (2013) accentuated the dominance of Islamic values or virtues over Islamic ethical behaviour, discussion on virtues (non-deontic), which deserves a study of its own, will not be included in this study.

Islamic ethics, thus, encourage individuals to acquire knowledge and a sense of obligation towards themselves and others. Aside from promoting the best conduct, the relevance of knowledge in the Islamic ethics concept is analogous to the importance of financial literacy in enabling individuals or businesses to protect themselves (self-governed) from the risk of falling victim to financial crimes.

In highlighting the role of ethics on the banks' performance, Islamic banks utilise business ethics as the precedent of market orientation in which market orientation is a determinant of business performance (Widana et al., 2015). Besides, Halamka and Teply (2017) also found that ethical banks reported significantly lower volatility of return on equity as compared to conventional banks.

The three elements of practices discussed in this section are important in supporting the bank in discharging corporate responsibility. As an explorative study, this study added to the field of Islamic banking research by looking at issues of reported court cases related to BIMB, including the due diligence concept, financial literacy, and Islamic ethics.

3.0 RESEARCH DESIGN

This study adopted a triangulation approach to analyse the data, comprising one hundred and forty-one court cases charged against BIMB from 1985 to 2021. The triangulation approach included a content analysis of court cases, trend analysis of the cases, and the analysis of annual report disclosure of cases. The triangulation approach refers to the use of multiple methods or data sources in qualitative research to develop a comprehensive understanding of phenomena (Patton, 1999). The data triangulation technique allowed this study to view the issues from multiple angles, thus, provided higher comprehension of the situation (Patton, 1999). This approach has been perceived as a strategy in qualitative research to test validity through the convergence of information from different sources. This technique applies the mixing of data to get integrated results to include various key sources of potential bias (Olsen, 2004; Hammerton & Munafo, 2021).

The data was gathered from the Current Law Journal online database as of 17th May 2021. The database was used as the source of data as it contains cases reported in Malaysia and published in the Current Law Journal from the year 1985 until 2021. The cases covered judgments from the High Court, Court of Appeal, and Federal Court of Malaysia. This study used BIMB as a benchmark in evaluating the *shariah* compliance requirement since it is the core condition for the establishment of the Islamic banking system (BIMB, 2022). This study focused on BIMB being the first Islamic bank to be established in Malaysia. The longitudinal approach allowed an analysis to see the trend of compliance level from the inception of the Islamic banking system in Malaysia until 17th May 2021. Muneeza (2017, 2018) used a similar method of analysing reported court cases in determining whether provisions invoked for the cases were in line with *shariah*. The present study employed three methods to analyse the one hundred and forty-one identified cases, including content analysis, trend analysis, and analysis of annual reports.

3.1 Content Analysis

The first phase involved content analysis, representing systematic assignment of communication contents of each case to different categories, according to rules, and analysing the relationships between categories using statistical methods (Riffe et al., 2005). The content analysis involved five stages. Firstly, searching and filtering the word “Bank Islam” from the Current Law Journal online database. Secondly, recording the details of the suitcases, including year, issue, and name of the bank involved in the cases. Thirdly, applying exclusion criteria of parties not involving BIMB. Fourthly, classifying cases into three categories: (1) *shariah* issues or contracts clarity for customers; (2) Crime-related cases, such as stealing, fraud, money laundering, and corruption; and (3) Contract disputes. Finally, separating default cases and non-default cases.

3.2 Trend Analysis

In the second phase, the study used time-series data to capture the trend of the issues faced by BIMB over time based on the information gathered in the first phase. Trend analysis on time-series data is an appropriate method for a retrospective longitudinal study in analysing a trend or pattern of issues over time (Salkind, 2010). In line with Oseni et al. (2016), time-series data was tested to evaluate the trend of the reported Islamic finance court case issues.

3.3 Analysis of Annual Report

Aside from the reported court cases, this study used information extracted from BIMB annual report from 2015 to 2019 as the source for data. This analysis was done to shed more evidence and validate findings from court cases analysis. Thus, relevant items in the available annual reports (2015–2019) on the website were extracted. The extracted items included three on- and one off-balance sheet gross items; (1) defaulted exposure, (2) credit risk mitigation covered by guarantees, and (3) credit risk mitigation covered by collateral, as well as (4) net financing, advances, and other. This study also extracted information on incidences of fraud and *shariah* non-compliance and their comments (i.e., explanations).

4.0 ANALYSIS AND DISCUSSION

4.1 Sample

The sample consisted of a hundred and forty-one reported BIMB-related cases. 92 cases were excluded as the bank name was only stated as referred case or had no relevance to its activity, or due to inaccessible documents. Hence, the final sample included only forty-nine cases. Table 1 summarised the details of the sample.

Table 1: Sample of the study

Cases	No		%	Remarks
Total	141		100.00	-
Less: Excluded	92	77	65.25	'Bank Islam' only appears as referred case
		10		'Bank Islam' appears only to its name without any relation to its activity
		5		Inaccessible documents
Total selected sample	49		34.75	-

4.2 Result of Content Analysis

As shown in Table 2, the result depicted that out of 49 selected court cases, only 8 cases (16%) were related to the issue of *shariah* compliance or clarity of contracts. In addition, the findings indicated that only a small percentage of *shariah* non-compliance was due to a lack of understanding in the contracts among the transacting parties. The remaining 41 cases (84%) were related to issues on the know-your-customer in which out of 41 cases, 16 cases (33%t) were related to customers default and financing, 11 cases (22%) were criminal-related, and 4 cases were on corruption and anti-money laundering. Another 14 cases (29%) were dispute ("other disputes") cases between contracting parties. These dispute cases occurred due to misunderstandings or conflicts between contracting parties regarding their transactions in which the bank did not have any direct role on the cases aside from providing its service to allow the financial transactions.

The finding suggests that issues that led to litigation cases related to BIMB were mainly related to common challenges of banking operations, which were found in previous studies, such as Aslam et al. (2020) and Bakar and Yasin (2019). These cases occurred in 40 years, from 1983 to 2021. Overall, the analysis on reported court cases showed that 84% of the 49 cases were related to default customers or know-your-customers compliance, with decreased occurrences over the years.

Table 2: Number of selected BIMB cases by categories

<table>
<tr><th colspan="6">Categories of Cases</th><th>No</th><th>%</th></tr>
<tr><td colspan="6">shariah-related or clarity of contract.</td><td>8</td><td>16</td></tr>
<tr><td rowspan="6">Know-your-customer compliance</td><td colspan="3">Know your customer sub-categories</td><td>No</td><td>%</td><td rowspan="6">41</td><td rowspan="6">84</td></tr>
<tr><td colspan="3">Customer financing defaults</td><td>16</td><td>33</td></tr>
<tr><td>Crime-related cases</td><td>No</td><td>%</td><td rowspan="3">11</td><td rowspan="3">22</td></tr>
<tr><td>● Fraud, corruption, and/or money laundering</td><td>7</td><td>14</td></tr>
<tr><td>● Other crimes</td><td>4</td><td>8</td></tr>
<tr><td colspan="3">Other disputes</td><td>14</td><td>29</td></tr>
<tr><td colspan="6">Total selected cases</td><td>49</td><td>100</td></tr>
</table>

4.3 Result of Trend Analysis

A total of 49 selected cases were re-categorised into four-period groups to reflect the trend of occurrences of each issue. The objective of this analysis was to gauge the trend of occurrence for each category of reported Islamic finance court cases (Oseni et al., 2016). The chart in Figure 2 depicted the number of reported cases involving BIMB from 1985 to 2020.

Overall, the trend analysis indicated a slight increase in cases from before 2005 to 2010. However, the trend presented a consistent overall decrease in the number of cases between 2011 and 2020. Cases related to the contract or *shariah* aspects presented a declining trend over the analysed period. Financial crimes occured less frequently than dispute cases, although both types of cases occurred continuously over the years. However, the result depicted an increasing trend for illegal or crime-related cases during the period between 2016 and 2020, after a declining trend between 2005 and 2015. In terms of *shariah* compliance, the result suggested that *shariah* compliance aspect had significantly improved Islamic banking operations. One possible explanation was the government efforts, such as the issuance of the *shariah* Governance Policy Document (BNM, 2019a), to strengthen the effectiveness of *shariah* governance implementation in banking operations (Isa et al., 2022).

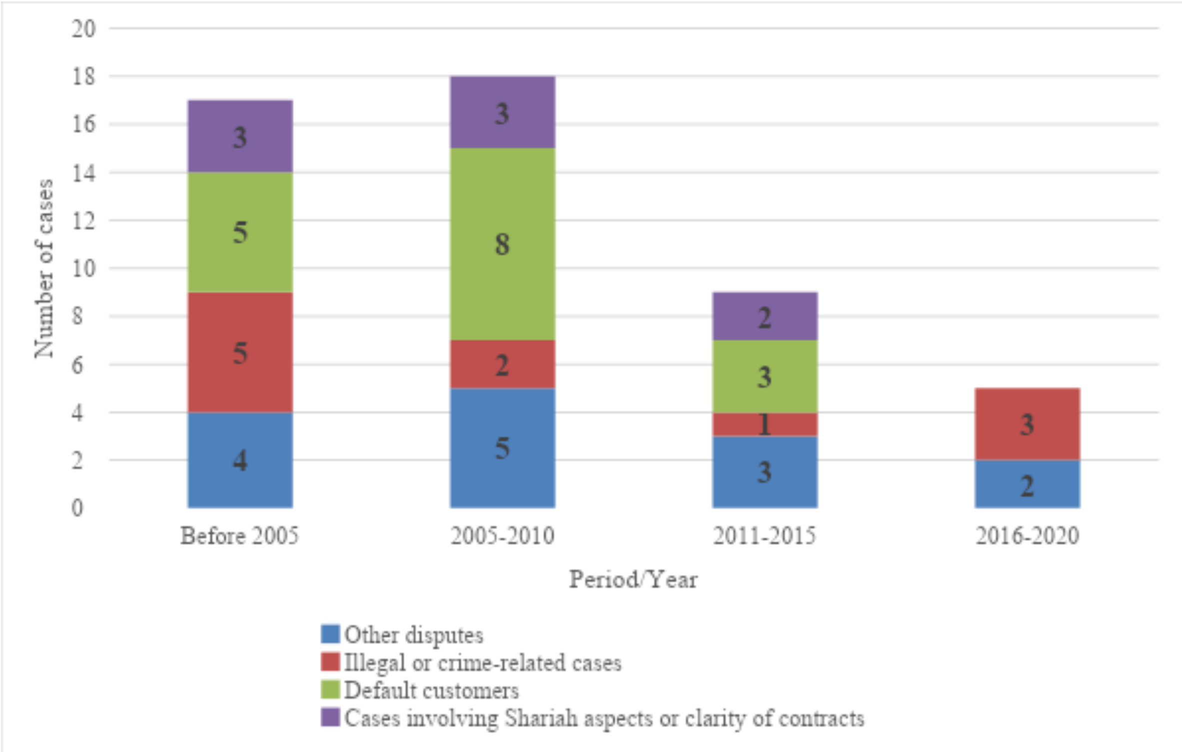

Figure 2: Trend of reported cases between 1985 and 2021

4.4 Analysis of Annual Report

This study further examined the occurrences of *shariah* issues and crime-related incidents based on the annual reports for the year between 2015 and 2019. The content analysis findings showed that no financial crime incidence was found throughout the period of analysis, except for two fraud incidents related to financing, and advances of the bank were reported in 2016. However, the trend suggested that *shariah* non-compliance events occurred every year from 2015 to 2019. The non-compliance issues were mainly due to operational failures, which represented a breach of *shariah* rules and principles and the lack of Shariah knowledge. A total of four *shariah* non-compliant events were reported in 2015. From 2015 to 2019, *shariah* non-compliance events reached the lowest in 2016, where only two incidences were reported. The *shariah* non-compliance incidents increased in 2017 and 2018, in which seven and eight *shariah* non-compliance incidents occurred in 2017 and 2018, respectively. *Shariah* non-compliance events decreased to five incidents in 2019. See Table 3 for details.

Table 3: Annual report analysis on *shariah* issues and financial crimes

Year	Issues		Types of Non-Compliance
	Fraud	*shariah* non-compliance	
2015	0	4	Operational failures in executing the 'aqad' and trade as well as gaps and system failures represent a violation of *shariah* rules and principles in products.
2016	2	2	Operational lapses in executing the contracts and services.
2017	0	7	Operational failures due to lack of awareness on the related *shariah* requirements for products offered.
2018	0	8	
2019	0	5	

Table 4 presented the bank's net value of financing and advances, total gross defaulted exposure as well as the percentage of the defaulted exposure over the financing net value and advances for each year from 2015 to 2019. Total gross defaulted exposure over net financing of BIMB was maintained below 2% over the years (2014–2019). Percentage of credit risk mitigation over total defaulted gross exposure had been increasing, but still at below 30%. This showed that the bank had strengthened risk mitigation efforts over the years while they kept the default risk at the lower level, though the number of consumers who were contained and exposed to default was not specified.

Table 4: Extract and analysis on gross default and credit risk mitigation

Category (RM'000)	2015	2016	2017	2018	2019
Off Balance Sheet Gross Defaulted Exposure	199,708	322,788	335,133	500,097	656,364
On Balance Sheet Gross Defaulted Exposure	8,574	9,235	24,185	12,050	14,687
Total Gross Defaulted Exposure	208,282	332,023	359,318	512,147	671,051
Net financing, advances, and others	34,294,690	39,189,274	42,113,420	45,680,680	49,472,522
Total Percentage of Total Gross Defaulted Exposure over Net Financing, Advances, and Others	**0.61%**	**0.85%**	**0.85%**	**1.12%**	**1.36%**
Credit Risk Mitigation (On-balance sheet): Covered by guarantees	2,627	2,451	2,386	70,729	97,715
Credit Risk Mitigation (On-balance sheet): Covered by collateral	11,691	20,027	60,324	70,910	71,738
Credit Risk Mitigation (Off-balance sheet): Covered by guarantees	-	-	-	1,632	1,303
Credit Risk Mitigation (Off-balance sheet): Covered by collateral	-	281	6,362	-	-
Total Credit Risk Mitigation	14,318	22,759	69,072	143,271	170,756
Percentage of Total Credit Risk Mitigation over Total Defaulted Gross Exposure	**6.87%**	**6.85%**	**19.22%**	**27.97%**	**25.45%**

4.5 Discussion

In summary, the results on the court cases analysis provided evidence on the improvement of banking operation by BIMB in terms of *shariah* compliance. The reduction of Shariah compliance-related cases over the years from 2011 onwards was parallel to the issuance of *Shariah* Governance Framework for Islamic Financial Institutions policy in 2010 and Islamic Financial Services Act (IFSA) 2013. The issuance of the *Shariah* Governance Framework in 2010 by BNM required all Islamic banks in Malaysia to establish a *shariah* governance structure (BNM, 2010). Islamic banks are also subject to further supervision on *shariah* compliance by BNM (Law of Malaysia, 2013). In 2019, BNM issued *Shariah* Governance Policy, which superseded *Shariah* Governance Framework 2010 (BNM, 2019b). However, the findings on the analysis of annual report disclosures on the number of *shariah* non-compliance incidents in BIMB's annual report (*shariah* non-compliance events section) from 2015 to 2019 appeared contradictory. *Shariah* non-compliance issues were reported every year, which indicated the lack of *shariah* requirement awareness. BIMB had clarified that the incidents were rectified accordingly in its annual report as per the BNM requirement.

In addition, the analysis of court cases in Table 2 also indicated that from the total of 49 cases, 24 cases were related to *shariah* contracts (including defaulting on *shariah* contracts), 11 cases related to crime, and 14 cases were related to disputes. It showed that crime-related cases and dispute cases occurred almost 50% less frequently than cases related to *shariah* contracts. The less frequent occurrences of court cases related to crime was parallel to the number of fraud incidents, which were caught and reported by BIMB, in the bank's annual report. The low number of crime-related cases, which persisted over the years, might have resulted from the existence of Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001, IFSA 2013, and other related guidelines issued by BNM previously (BNM, 2020c). Based on the issue on know-your-customer compliance, the findings found that the court cases analysis was consistent with Aslam et al. (2020) who found the same issue of default customers faced by Grameen bank. Aslam et al. (2020) found inappropriate or unfavourable financing to customers caused their reluctance to repay the financing.

Furthermore, analysis on the gross default and credit risk mitigation of BIMB showed that the bank had strengthened risk mitigation efforts over the years while keeping the default risk at a low level (below 2%). The analysis showed that the number of reported court cases since BIMB inception until 2010 was reduced to half (from 35 cases between 1985 and 2010) to only 14 cases (from 2011 to 2020) might coincide with the issuance of Guidelines on the Recognition and Measurement of Profit-Sharing Investment Account as Risk Absorbent by BNM (2008), which became effective on 1st July 2011. The policy stated the quantum of risk absorbent in measuring risk-weighted assets for Islamic banks (BNM, 2008). This policy was superseded by Capital Adequacy Framework for Islamic Banks (Capital Components) policy issued in December 2020 (BNM, 2020a). The aspect of credit risk mitigation for Islamic banks was covered in the Capital Adequacy Framework for Islamic Banks (risk-weighted assets) policy issued in 2019 (BNM, 2019a).

To sum up, the findings suggested that the issue of the know-your-customer compliance is vital to effectively address financial integrity and inclusion (Alliance for Financial Inclusion, 2019). However, there are difficulties in fighting crimes globally via enforcement of regulatory tools, such as know-your-customer enforcement (Mugarura, 2017). Hasan and Asutay (2011) also acknowledged the inevitability of disputes in the growing Islamic finance industry. Meanwhile, the enhancement of the know-your-customer principle is consistent with the BNM requirement for better governance as specified in its guidelines on financial crime and due diligence. Moreover, BNM (2022b) introduced three related policies; (i) Guidance on Verification of Individual Customers for Customer Due Diligence Anti-Money Laundering, Countering Financing of Terrorism and Targeted Financial Sanctions for Financial Institutions, Designated Non-Financial Businesses and Professions and Non-Bank Financial Institutions (AML/CFT and TFS for FIs, DNFBPs, and NBFIs), (ii) Risk Management in Technology (RMiT), and (iii) e-KYC. Another two related policies were also introduced; (i) Operational Risk Integrated Online Network (ORION) and (ii) Management of Customer Information and Permitted Disclosures. These policies were introduced effectively in 2020 and 2021, respectively (BNM, 2022b).

Second, this study backed up prior research by Oseni et al. (2016) and Mugarura (2017) on the need for parties involved in financial activities or transactions to have a clear understanding of the various requirements in favour of making informed decisions. The financial literacy of individuals must be improved as it leads to greater financial inclusion (Hasan et al., 2021), lower default risks (Kurowski, 2021), and acts as primary measure in combating crimes (Mugarura, 2017). Individuals with higher level of financial literacy enjoy the financial solutions offered and therefore may lead to greater empowerment of the people. In the present study, the results suggested that emphasis should be given by banking practitioners on the importance of enhancing the *shariah* knowledge of Islamic banking among the stakeholders (Dewa & Zakaria, 2012; Salh & Mohammed, 2019), and the distinction of banking operations between conventional and Islamic finance. Finally, both employees and customers must internalise Islamic ethics in aiming for the best conduct in performing their duties and fulfilling the rights of each individual, hence reducing occurrences of *shariah* non-compliance incidents, misconduct, and disputes. While previous studies focused on the ethical conduct of service providers and businesses when providing their services and products, there is a lack of studies on the ethical conduct that consumers should exhibit. Islamic ethics lead to the pursuit of rewards from the Creator (Vishanoff, 2020), and ultimately leads to excellence

(Aydin, 2020). As Aydin (2020) accentuated, the economic, institutional, social, and educational enablers are important for virtuous social life.

5.0 CONCLUSION

This study is original in terms of triangulation methods used, i.e., the use of court cases and annual reports as sources. Thus, this study provided a more comprehensive perspective and analysis in assessing the occurrences of banking issues in the operation of a bank. Based on the analysis, BIMB managed to reduce the total occurrences of litigation cases covering *shariah*-related cases, crimes, defaults, and disputes cases over the years, reflecting improved performance in terms of services. As all types of cases (except for *shariah*-related issues) were within the due diligence concept, this finding highlighted the need for a bank to improve on know-your-customer compliance towards better governance. Meanwhile, analysis on BIMB's gross default and credit risk mitigation also showed that the bank had strengthened risk mitigation efforts over the years and maintained a low default risk level (below 2%).

This study also highlighted the importance of adequate individual financial literacy as financial literacy leads to wider financial inclusion (Hasan et al., 2021), lowers default risks (Kurowski, 2021), and provides primary measures in combating crimes (Mugarura, 2017). Meanwhile, due to the yearly occurrences of *shariah*-noncompliant incidents, banking practitioners need to enhance their *shariah* knowledge of Islamic banking (Dewa & Zakaria, 2012; Salh & Mohammed, 2019). Islamic ethics also needs to be instilled as it guides individuals in demonstrating their best conduct in discharging their duties and fulfilling the rights of others, to overcome issues related to misconduct, disputes, and *shariah* non-compliance incidents, be it among customers or employees. This study limits its focus on BIMB as an explorative study. More research is needed to include analysis of other banks, besides broadening the scope of the study to include social and environmental financing and measuring the impact of consumer financing.

ACKNOWLEDGEMENTS

This article is funded by the Accounting Research Institute HICoE, Ministry of Higher Education and Faculty of Business and Management for completing this study [600-TNCPI 5/3/DFF (FPP) (20/2020)].

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